

## ICRA Lanka assigns the issuer rating of [SL]BBB+ with stable outlook to Softlogic Capital PLC

July 08, 2019

Instrument*	Previous Rated Amount (LKR Mn)	Current Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	N/A	[SL]BBB+ (Stable); assigned

### Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has assigned the issuer rating of [SL]BBB+ (pronounced SL triple B plus) with stable outlook to Softlogic Capital PLC (SCAP or "the Company").

### Rationale

The rating factors in the Company's sizeable shareholding (about 52%) in Softlogic Life Insurance (SLI; rated [SL]A/stable for insurance financial strength), the fourth largest life insurer in Sri Lanka and the synergies from being part of the diversified conglomerate, Softlogic Holdings PLC (SHL; rated [SL]BBB+/stable). ICRA Lanka, however, notes that the large capex plans of the group entities of SHL would limit its ability to provide any sizeable financial support to SCAP. ICRA Lanka is cognizant of SCAP's dependence on dividend income from its subsidiaries, SLI and Softlogic Finance PLC (SFP; issuer rating of [SL]BB/negative outlook), as a key source of revenue, which can expose it to the risk of experiencing cashflow/ dividend volatility. Nevertheless, the growth of the Company's fund management business and anticipated increase in fee-based income may somewhat mitigate the cashflow risk in the future. The rating factors in SCAP's current low leverage (standalone gearing of 0.5x in FY19, networth of LKR 3 Bn), however the immediate capital needs of SFP to meet regulatory requirements may necessitate additional borrowings by SCAP in the near term. Going forward, performance of the subsidiaries, and maintaining healthy levels of liquidity and capitalization, are key from a ratings perspective.

### Outlook: Stable

The outlook may be revised to "Positive" if SCAP's standalone financial profile improves significantly or if the risk profile of the subsidiaries improves. The outlook may be revised to "Negative" in case of an increase in standalone leverage, weakening in its liquidity and earnings or in case of a deterioration in the risk profile of its subsidiaries.

### Key rating drivers

#### Credit strengths

**Part of the Softlogic group; sizeable shareholding in Softlogic Life insurance:** SCAP represents the financial services arm of diversified conglomerate, SHL. Being part of the Softlogic group provides access to managerial and financial support from the group entities and the ability to leverage synergies between different business units. However, ICRA Lanka takes note of the large capex plans of group entities that would limit SHL's ability to support SCAP in the near to medium term. SCAP holds a 52% stake in SLI, the 4<sup>th</sup> largest life insurance provider in Sri Lanka as in March 2019. SLI's core net profits (excluding deferred

tax assets and one-off gains) stood at LKR 1,106 Mn and LKR 1,095 Mn in CY2017<sup>1</sup> and CY2018, respectively. The healthy internal generation of the life insurer is expected to support its growth capital requirements; thus SCAP may not have to extend any support to the subsidiary in the medium term. However, conversely, regulatory requirements and expansion needs of SLI would limit it from extending any additional financial support, apart from regular dividends (dividend payout has been on average 33% in the past five years; SLI did not pay a dividend every year) to SCAP.

**Comfortable capitalization profile, however coverage indicators are moderate:** As in March 2019, total standalone borrowings of SCAP stood at LKR 1,513 Mn against a total net worth of LKR 3 Bn; gearing as in March 2019 stood at 0.50x vis-à-vis 0.43x in March 2018 and 0.41x in March 2017. Stand-alone gearing has remained at relatively low levels for the Company in recent years, as it has not undertaken any new investments. The standalone interest cover<sup>2</sup> stood at 1.23x and 1.68x in FY2019 and FY2018, respectively. If long term debt is obtained (which may be utilized for the purposes of bolstering the regulatory capital of its NBFi subsidiary), total gearing may increase to about 0.66x and interest cover could drop to around 1.0x. Consolidated gearing is moderately high at 4.22x (5.89x including insurance contract liabilities) as in March 2019; however, stand-alone gearing is expected to remain at relatively modest levels, as the Company is not expecting to make any significant new investments in the near term.

**Adequate near term liquidity; medium term repayments have to be refinanced:** The Company does not have any sizeable repayments in FY2020 (LKR 97 Mn) and in FY2021 (LKR 22Mn) and sizeable repayments (1,256 Mn) fall due in FY2022. SCAP has structured all its debt payments into long term bullet re-payments, as opposed to regular loan amortization, which provides some comfort from a near term liquidity perspective; however, ICRA Lanka notes that the Company would have to refinance these bulk repayments over the medium term.

## Credit challenges

**Capital requirements of Softlogic Finance PLC:** As in March 2019, SCAP was the controlling shareholder of SFP, with 67% ownership. Currently, SFP operates below the regulatory capital requirement and will require around LKR 2.0 Bn in fresh equity capital over the next 2 years, out of which LKR 500-600Mn will be required in the near term. To meet the capital needs of its NBFi subsidiary, SCAP is expected to raise funds through various means, including raising additional equity capital. ICRA Lanka expects SCAP to provide temporary funding support to SFP to meet the immediate capital deficiency by raising long term debt. Given the Company's healthy capitalization profile and relationships with banks, ICRA Lanka envisages same to be raised comfortably. However, considering the sizable capital requirement for SFP over the medium term, it would be crucial for SCAP to raise equity capital.

**Lumpy earnings profile; dependence on dividend income:** As in March 2019, investments in group entities accounted for close to 92% (94% in March 2018) of the total standalone asset base of SCAP. Correspondingly, dividend income from subsidiaries (mainly SLI) has been a key source of income for SCAP (68% of total revenue in FY2019 vis-à-vis 15% in FY2018 and 80% in FY2017), with the balance represented by fee income from providing services, including fund management, to its subsidiaries. ICRA Lanka notes that the dividend payouts of SLI and SFP, are subject to the regulatory and growth capital requirements of the respective entities, which exposes SCAP to the risk of dividend/cashflow volatility. On account of lower dividend income received, SCAP's standalone profitability has been subdued in the last two years (PAT was LKR 49 in FY2019 and LKR 108 Mn in FY2018). On a consolidated basis, group PAT

<sup>1</sup> CY- Calendar Year

<sup>2</sup> (Operating income-operating expenses)/ interest income

stood at LKR 3.2 Bn in FY2019, representing a 45% increase over the previous year, largely driven by SLI's performance and one-time gains.

**Analytical approach:** For arriving at the ratings, ICRA Lanka has applied its rating methodologies as indicated below.

**Links to applicable criteria:** [ICRA Lanka Issuer Rating Methodology](#)

### **About the company:**

Softlogic Capital PLC (SCAP) is a holding company under the Softlogic Group, a diversified conglomerate, listed on the Colombo Stock Exchange (CSE) with interests in healthcare, retail, financial services, ICT, leisure and automotive sectors. A listed company itself, Softlogic Capital PLC has two listed subsidiaries, Softlogic Life Insurance PLC, (a licensed insurance company, with 52% holding) and Softlogic Finance PLC (a licensed finance company, with 67% holding). The Company also fully owns Softlogic Stock Brokers (Pvt) Ltd, a licensed stock broker of the Colombo Stock Exchange and Softlogic Asset Management (Pvt) Ltd, an investment management company.

For FY2019, SCAP (standalone) reported a net profit of LKR 49 Mn on a gross income of LKR 414 Mn as compared with a net profit of LKR 108 Mn on a gross income of 435 Mn in the previous fiscal.

For FY2019, the SCAP group reported a consolidated net profit of LKR 3,198 Mn on a gross income of LKR 15.0 Bn, compared to a net profit of LKR 2,207 Mn on a gross income of LKR 12.9 Bn in the previous fiscal.

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